MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

FINANCIAL AUDIT
OF THE

MICHIGAN LEGISLATIVE RETIREMENT SYSTEM

October 1, 2002 through September 30, 2004

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

03-140-05

"…The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof."

– Article IV, Section 53 of the Michigan Constitution

Audit report information may be accessed at:
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Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit

Michigan Legislative Retirement System

October 1, 2002 through September 30, 2004

Report Number:
03-140-05

Released:
October 2005

A financial audit determines if the financial statements are fairly presented; considers internal control over financial reporting; and determines compliance with State compliance requirements material to the financial statements. This financial audit of the Michigan Legislative Retirement System (MLRS) was conducted as part of the constitutional responsibility of the Office of the Auditor General.

Financial Statements:

Auditor's Report Issued

We issued an unqualified opinion on the MLRS financial statements.

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Internal Control Over Financial Reporting

We did not report any findings related to internal control over financial reporting.

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Noncompliance or Other Matters Material to the Financial Statements

We did not identify any instances of noncompliance or other matters applicable to the financial statements that are required to be reported under *Government Auditing Standards*.

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Background:

MLRS is a single employer, public employee, defined benefit plan governed by the State of Michigan. MLRS was created by Act 261, P.A. 1957, and provides retirement and ancillary benefits to eligible current and former State legislators. MLRS's financial statements are included as a pension trust fund in the combined financial statements of the State of Michigan.

MLRS operates within the legislative branch of State government. The MLRS Board of Trustees appoints the director who serves as executive secretary to the MLRS Board, with whom the general oversight of MLRS resides. Act 486, P.A. 1996, amended the MLRS enabling statute to mandate that persons elected to the

Michigan Legislature after March 30, 1997, participate in a Statewide defined contribution plan administered by the Department of Management and Budget. Thus, the defined benefit plan is a closed plan. The defined contribution plan operates in a manner similar to a 401(k) plan as part of the State Employees' Defined Contribution Retirement Fund.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: http://audgen.michigan.gov

Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General

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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

October 25, 2005

Mr. R. Robert Geake, Chairperson
Board of Trustees
and
Ms. Christine I. Hammond, Director
Michigan Legislative Retirement System
Cora Anderson Building
Lansing, Michigan

Dear Mr. Geake and Ms. Hammond:

This is our report on the financial audit of the Michigan Legislative Retirement System for the period October 1, 2002 through September 30, 2004.

This report contains our report summary, our independent auditor's report on the financial statements, management's discussion and analysis, and the Michigan Legislative Retirement System financial statements and notes to the financial statements. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters, required supplementary information, and a glossary of acronyms and terms.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish

Thomas H. McTavish, C.P.A.
Auditor General

03-140-05

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TABLE OF CONTENTS

MICHIGAN LEGISLATIVE RETIREMENT SYSTEM

	Page
INTRODUCTION	
Report Summary	1
Report Letter	3
INDEPENDENT AUDITOR'S REPORT	
Independent Auditor's Report on the Financial Statements	8
MANAGEMENT'S DISCUSSION AND ANALYSIS	
Management's Discussion and Analysis	11
FINANCIAL STATEMENTS	
Michigan Legislative Retirement System Financial Statements	
Statement of Pension Plan and Postemployment Healthcare Plan Net Assets	16
Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets	17
Notes to the Financial Statements	18

INDEPENDENT AUDITOR'S REPORT ON
INTERNAL CONTROL AND COMPLIANCE

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters 30

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress 33

Schedule of Contributions From the Employer and Other Contributing Entities 34

Notes to the Required Supplementary Information 35

GLOSSARY

Glossary of Acronyms and Terms 38

INDEPENDENT AUDITOR'S REPORT

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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on
the Financial Statements

Mr. R. Robert Geake, Chairperson
Board of Trustees
and
Ms. Christine I. Hammond, Director
Michigan Legislative Retirement System
Cora Anderson Building
Lansing, Michigan

Dear Mr. Geake and Ms. Hammond:

We have audited the financial statements of the Michigan Legislative Retirement System, as of and for the fiscal years ended September 30, 2004 and September 30, 2003, as identified in the table of contents. These financial statements are the responsibility of the Michigan Legislative Retirement System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 2, the financial statements present only the Michigan Legislative Retirement System and do not purport to, and do not, present fairly the financial position of the State of Michigan or its pension trust funds as of September 30, 2004 and September 30, 2003 and the changes in financial position thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan Legislative Retirement System as of September 30, 2004 and September 30, 2003 and the changes in financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 11 through 13 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of funding progress and schedule of contributions from the employer and other contributing entities and related notes are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. These schedules have been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 15, 2005 on our consideration of the Michigan Legislative Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of the internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Sincerely,

Thomas H. McTavish

Thomas H. McTavish, C.P.A.
Auditor General
April 15, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

The management's discussion and analysis of the Michigan Legislative Retirement System (MLRS) provides an overview of the financial activities and performance for the fiscal years ended September 30, 2004 and September 30, 2003. This information should be read in conjunction with the financial statements and required supplementary information. MLRS's management is responsible for the financial statements, notes to the financial statements, required supplementary information, and this discussion.

<u>Financial Overview</u>

Statement of Pension Plan and Postemployment Healthcare Plan Net Assets

The statement of plan net assets presents information on MLRS's assets and liabilities using the accrual basis of accounting. Over time, increases or decreases in net assets may serve as a useful indicator of MLRS's financial strength or weakness. MLRS's plan net assets for the fiscal years ended September 30, 2004 and September 30, 2003 **increased** by $11,083,886, or 7.1%, and $16,701,289, or 11.9%, respectively, which was primarily due to the increase in the market value of the MLRS investments.

Condensed Financial Information From the
Statement of Pension Plan and Postemployment
Healthcare Plan Net Assets
<u>As of September 30</u>
(In Thousands)

	2004	2003	Increase (Decrease) Amount	Increase (Decrease) Percentage	2002	Increase (Decrease) Amount	Increase (Decrease) Percentage
Assets							
Cash	$ 3,448	$ 1,169	$ 2,279	195.0%	$ 2,994	$ (1,825)	(61.0)%
Receivables	360	1,023	(663)	(64.8)%	731	292	39.9%
Investments	165,053	155,722	9,331	6.0%	137,618	18,104	13.2%
Total Assets	$168,861	$157,914	$10,947	6.9%	$141,343	$16,571	11.7%
Liabilities							
Warrants outstanding	$ 31	$ 47	$ (16)	(34.0)%	$ 35	$ 12	34.3%
Accounts payable	614	734	(121)	(16.5)%	877	(142)	(16.2)%
Total Liabilities	645	782	(137)	(17.5)%	912	(130)	(14.3)%
Total Net Assets	$168,216	$157,132	$11,084	7.1%	$140,431	$16,701	11.9%

Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets

Additions to Plan Net Assets

The reserves needed to finance benefits provided by MLRS are accumulated through the collection of court fees and member and employer contributions and through earnings on investments. Contributions and investment income/loss for fiscal year 2003-04 totaled $23,385,091. Total additions to plan net assets **decreased** 18.1% from the prior year due primarily to the fact that, while the market value of MLRS investments did increase for fiscal year 2003-04, the increase was less dramatic than the investment gains of the previous fiscal year. Investment gains slowed from the previous fiscal year due to weaker economic and market activity. Contributions and investment income/loss for fiscal year 2002-03 totaled $28,549,166. Total additions to plan net assets **increased** 468.2% from the prior year due primarily to the net increase in the fair value of MLRS investments.

Deductions From Plan Net Assets

The expenses of MLRS include the payments of pension and life insurance benefits to members and beneficiaries; the payments for health and dental benefits; the refund or transfer of contributions to former members; and the cost of administering MLRS. Total expenses for fiscal year 2003-04 were $12,301,205, an **increase** of 3.8% over 2002-03 expenses. Total expenses for fiscal year 2002-03 were $11,847,877, an **increase** of 16.1% over 2001-02 expenses. The increases are primarily due to the increase in retirement and healthcare benefit expenses.

Condensed Financial Information From the
Statement of Changes in Pension Plan and
Postemployment Healthcare Plan Net Assets
As of September 30
(In Thousands)

	2004	2003	Increase (Decrease) Amount	Increase (Decrease) Percentage	2002	Increase (Decrease) Amount	Increase (Decrease) Percentage
Additions							
Member contributions	$ 197	$ 234	$ (37)	(15.8)%	$ 358	$ (124)	(34.6)%
Employer contributions	2,947	2,947	0		3,116	(169)	(5.4)%
Court fees	1,231	1,080	151	14.0%	1,095	(15)	(1.4)%
Net investment income (loss)	19,010	24,288	(5,278)	(21.7)%	(12,322)	36,610	297.1%
Total Additions	$23,385	$ 28,549	$(5,164)	(18.1)%	$ (7,753)	$ 36,302	468.2%
Deductions							
Retirement benefits	$ 7,875	$ 7,352	$ 523	7.1%	$ 6,540	$ 812	12.4%
Health and dental benefits	3,965	3,644	321	8.8%	3,116	528	16.9%
Death benefits	141	386	(245)	(63.5)%	287	99	34.5%
Refunds of contributions and interest and transfers to other systems	16	168	(152)	(90.5)%		168	N/A
Administrative expenses	304	298	6	2.0%	266	32	12.0%
Total Deductions	$12,301	$ 11,848	$ 453	3.8%	$ 10,209	$ 1,639	16.1%
Net Increase (Decrease)	$11,084	$ 16,701	$(5,617)	(33.6)%	$(17,962)	$ 34,663	193.0%

Overall Financial Analysis

During fiscal year 2003-04, the economy showed signs of strengthening throughout the year, although rising energy prices and tightening monetary policy controlled economic expansion. While investment gains were less dramatic than in fiscal year 2002-03, the MLRS pension fund still experienced significant positive growth. During fiscal year 2002-03, the success of the principal military campaign in Iraq and some signs of economic strengthening helped equity markets rebound through the year. Also during fiscal year 2002-03, all major equity markets reported positive performance for the year, allowing the MLRS pension fund to post much-needed positive returns. The positive growth over the last two years has allowed the MLRS to retain its actuarially overfunded status.

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FINANCIAL STATEMENTS

MICHIGAN LEGISLATIVE RETIREMENT SYSTEM
Statement of Pension Plan and Postemployment Healthcare Plan Net Assets
As of September 30

	2004			2003		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
ASSETS						
Cash	$ 3,247,389	$ 200,739	$ 3,448,128	$ 1,106,665	$ 62,466	$ 1,169,131
Receivables:						
Employer	$ 109,663	$ 6,779	$ 116,442	$ 92,243	$ 5,207	$ 97,450
Interest and dividends	56,232	3,476	59,708	44,138	2,491	46,629
Sale of investments	173,357	10,716	184,073	832,351	46,982	879,333
Total Receivables	$ 339,252	$ 20,971	$ 360,223	$ 968,732	$ 54,680	$ 1,023,412
Investments:						
Common stock	$ 62,132,400	$ 3,840,738	$ 65,973,138	$ 58,942,498	$ 3,327,009	$ 62,269,507
Mutual funds	93,311,524	5,768,086	99,079,610	88,459,141	4,993,076	93,452,217
Total Investments	$ 155,443,924	$ 9,608,824	$ 165,052,748	$ 147,401,639	$ 8,320,085	$ 155,721,724
Total Assets	$ 159,030,565	$ 9,830,534	$ 168,861,099	$ 149,477,036	$ 8,437,231	$ 157,914,267
LIABILITIES						
Warrants outstanding	$ 29,045	$ 1,795	$ 30,840	$ 44,889	$ 2,534	$ 47,423
Accounts payable and other liabilities	578,251	35,745	613,996	695,225	39,242	734,467
Total Liabilities	$ 607,296	$ 37,540	$ 644,836	$ 740,114	$ 41,776	$ 781,890
Net Assets Held in Trust for Pension and Healthcare Benefits	$ 158,423,269	$ 9,792,994	$ 168,216,263	$ 148,736,922	$ 8,395,455	$ 157,132,377

A schedule of funding progress is presented as required supplementary information.

The accompanying notes are an integral part of these financial statements.

MICHIGAN LEGISLATIVE RETIREMENT SYSTEM
Statement of Changes in Pension Plan and Postemployment Healthcare Plan Net Assets
For Fiscal Years Ended September 30

	2004			2003		
	Pension Plan	Health Plan	Total	Pension Plan	Health Plan	Total
ADDITIONS						
Member contributions:						
Other member contributions	$ 27,628	$ 169,871	$ 197,499	$ 32,952	$ 201,434	$ 234,386
Military contributions			0			0
Employer contributions		2,947,200	2,947,200		2,947,200	2,947,200
Court fees		1,230,812	1,230,812		1,080,029	1,080,029
Total Contributions	$ 27,628	$ 4,347,883	$ 4,375,511	$ 32,952	$ 4,228,663	$ 4,261,615
Investment income (loss):						
Net increase (decrease) in fair value of investments	$ 15,718,732	$	$ 15,718,732	$ 21,351,059	$	$ 21,351,059
Interest, dividends, and other	2,801,421	1,014,521	3,815,942	2,190,233	1,163,398	3,353,631
Total Investment Income (Loss)	$ 18,520,153	$ 1,014,521	$ 19,534,674	$ 23,541,292	$ 1,163,398	$ 24,704,690
Less investment expenses	(525,094)		(525,094)	(417,147)		(417,147)
Net Investment Income (Loss)	$ 17,995,059	$ 1,014,521	$ 19,009,580	$ 23,124,145	$ 1,163,398	$ 24,287,543
Miscellaneous income	$	$	$	$ 8	$	$ 8
Total Additions	$ 18,022,687	$ 5,362,404	$ 23,385,091	$ 23,157,105	$ 5,392,061	$ 28,549,166
DEDUCTIONS						
Benefits and refunds paid to plan members and beneficiaries:						
Retirement benefits	$ 7,875,376	$	$ 7,875,376	$ 7,351,848	$	$ 7,351,848
Health benefits		3,652,317	3,652,317		3,315,871	3,315,871
Dental benefits		312,548	312,548		327,804	327,804
Death benefits	140,500		140,500	386,000		386,000
Refund of contribution and interest	16,062		16,062	36,189		36,189
Transfers to other systems				132,307		132,307
Administrative expenses	304,402		304,402	297,858		297,858
Total Deductions	$ 8,336,340	$ 3,964,865	$ 12,301,205	$ 8,204,202	$ 3,643,675	$ 11,847,877
Net Increase (Decrease)	$ 9,686,347	$ 1,397,539	$ 11,083,886	$ 14,952,903	$ 1,748,386	$ 16,701,289
Net Assets Held in Trust for Pension and Healthcare Benefits:						
Beginning of Year	148,736,922	8,395,455	157,132,377	133,784,019	6,647,069	140,431,088
End of Year	$ 158,423,269	$ 9,792,994	$ 168,216,263	$ 148,736,922	$ 8,395,455	$ 157,132,377

A schedule of funding progress is presented as required supplementary information.

The accompanying notes are an integral part of these financial statements.

Note 1 Plan Description

a. Organization

The Michigan Legislative Retirement System (MLRS) is a single employer, public employee, defined benefit plan governed by the State of Michigan. MLRS was created by Act 261, P.A. 1957, and provides retirement and ancillary benefits to eligible current and former State legislators. MLRS's financial statements are included as a pension trust fund in the combined financial statements of the State of Michigan.

MLRS operates within the legislative branch of State government. The MLRS Board of Trustees appoints the director who serves as executive secretary to the MLRS Board, with whom the general oversight of MLRS resides. Act 486, P.A. 1996, amended the MLRS enabling statute to mandate that persons elected to the Michigan Legislature after March 30, 1997, participate in a Statewide defined contribution plan administered by the Department of Management and Budget. Thus, the defined benefit plan is a closed plan. The defined contribution plan operates in a manner similar to a 401(k) plan as part of the State Employees' Defined Contribution Retirement Fund.

b. Membership

At September 30, 2004 and September 30, 2003, MLRS's membership consisted of the following:

	2004	2003
Retirees and beneficiaries currently receiving benefits*:		
Regular benefits	195	189
Survivor benefits	73	73
Disability benefits	0	0
Total	268*	262*
Current members:		
Vested	23	23
Nonvested	1	1
Total	24	24
Inactive members entitled to benefits and not yet receiving them	71	79
Total All Members*	363	365

* Includes 8 domestic relations order* alternate payees for 2004 and 7 domestic relations order alternate payees for 2003.

** See glossary at end of report for definition.*

MLRS provides health, dental, vision, and life insurance benefits. The number of plan participants at September 30, 2004 and September 30, 2003 is as follows:

	2004	2003
Health/Dental/Vision Plan:		
Eligible participants	343**	342**
Participants receiving benefits	343**	342**
Life Insurance Plan:		
Participants receiving benefits	267	273

** Includes 19 defined contribution plan participants for 2004 and 2003, who are receiving health care insurance through MLRS in accordance with State statute.

c. Benefit Provisions

(1) Introduction:
Act 261, P.A. 1957, as amended (the Michigan Legislative Retirement System Act), establishes eligibility and benefit provisions for the defined benefit plan.

Michigan's constitutional term-limit amendment limits members of the House of Representatives to six years in office and members of the Senate to eight years in office. Effective March 31, 1997, Act 486, P.A. 1996, closed MLRS to new legislators. The act provides certain re-elected former legislators the option to rejoin MLRS. All legislators who first take office after 1997 are automatically enrolled in the State's defined contribution plan.

(2) Regular Retirement:
A member may retire and receive retirement benefits based on age and service after: (1) attaining age 50, if age and years of credited service combined are equal to or greater than 70; or (2) attaining age 55 with 5 or more years of credited service if elected, qualified, and

seated not less than (a) 3 full or partial terms in the House of Representatives, (b) 2 full or partial terms in the Senate, or (c) 1 term in the House of Representatives and 1 term in the Senate.

A member's retirement benefit is computed using a benefit formula prescribed by the enabling statute and described in the next two paragraphs. The benefit is paid on a monthly basis.

For those legislators who first became members on or before January 1, 1995, the retirement benefit is calculated by multiplying 20% of the highest salary earned for the first 5 years of service, plus 4% of the highest salary for each of the next 11 years of service, plus 1% of the highest salary for each additional year.

For those legislators who first became members after January 1, 1995, the retirement benefit is calculated by multiplying 3% of the highest salary for each year of service.

(3) Post Retirement Benefit Adjustment:
For those legislators who first became members on or before January 1, 1995, the annual retirement benefit payable to a retiree and/or his/her survivor is increased by 4% compounded annually. The adjustment is effective each January.

For those legislators who first became members after January 1, 1995, the annual retirement benefit payable to a retiree and/or his/her survivor is increased by 4%, but it is not compounded annually. The adjustment is effective each January.

(4) Other Post Employment Benefits:
MLRS provides $150,000 in life insurance coverage to active members. Deferred vested members* are covered by varying amounts of life insurance, ranging from $5,000 to $150,000, depending on the member's date of deferral and, in some instances, the payment of an annual premium. Retirees are covered by varying

** See glossary at end of report for definition.*

amounts of life insurance, ranging from $2,500 to $75,000, depending on their retirement dates and, in some instances, the payment of an annual premium. MLRS prefunds life insurance benefits using the entry age normal actuarial cost method*. The life insurance plan and the pension plan use the actuarial assumptions stated in Note B of the required supplementary information section.

Under Sections 50a and 50b of the Michigan Legislative Retirement System Act, all retirees and their dependents and survivors receive health, dental, vision, and hearing insurance coverage. MLRS also provides health, dental, vision, and hearing insurance coverage for deferred vested members who were members on or before January 1, 1995, and for their survivors and dependents. In addition, in accordance with State law, MLRS provides health insurance coverage to eligible former legislators (and their dependents) who meet certain vesting requirements established by statute and who belong to the State's defined contribution plan. MLRS pays for health, dental, vision, and hearing benefits on a modified pay-as-you-go basis*; however, the State has begun to advance fund for future MLRS health insurance costs.

(5) Disability Benefit:
A member or deferred vested member who becomes disabled as determined by at least two licensed physicians appointed by the Board of Trustees is eligible for a disability benefit computed in the same manner described under "Regular Retirement."

(6) Survivor Benefit:
Upon the death of a vested member or deferred vested member who meets the service, but not the age requirements, for regular retirement (see "Regular Retirement"), or upon the death of a retiree, a surviving spouse shall be entitled to a benefit equal to 66.67% of the benefit the member would have received or was receiving at the time of death. Special provisions apply to surviving minor children and surviving spouses with minor children.

** See glossary at end of report for definition.*

(7) Refunds:

A member who leaves legislative service may request a refund of his/her contributions from the Members' Savings Fund. A member who receives a refund of contributions forfeits all rights to any future MLRS benefits. Members who return to legislative service and who previously received a refund of their contributions may reinstate their service through repayment of the refund plus interest in accordance with the statute.

Note 2 Summary of Significant Accounting Policies

a. Measurement Focus, Basis of Accounting, and Presentation

The MLRS financial statements are presented using the economic resources measurement focus and the accrual basis of accounting, as provided by generally accepted accounting principles applicable to governments. Contributions are recognized as revenue in the period in which service is provided, and expenses are recorded when incurred regardless of when payment is made. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

b. Contributions and Reserves

The Michigan Legislative Retirement System Act provides for several reserves or funds. These funds and the contributions and other monies allocated to them are described below:

(1) Members' Savings Fund (MSF) - Until January 1, 1999, members who first became members before December 1, 1994, with less than 20 years of service, contributed approximately 7% of salary to MSF, and members who first became members on or after January 1, 1995, contributed 5% of salary to MSF. After January 1, 1999, members who first became members on January 1, 1995, contributed 4% of salary to MSF until December 31, 2000. After January 1, 1999, there are no member contributions allocated to MSF. Eligible members may make other contributions to MSF to purchase special service credit or to repay previously refunded contributions. MSF represents active member contributions (and interest credited from the Income

Fund) less amounts transferred to reserves for retirement and amounts refunded to terminated members.

(2) Members' Retirement Fund (MRF) - MRF represents the reserves for payment of retirement benefits. At retirement, a member's accumulated contributions (with interest) are transferred to MRF (from MSF). Interest is credited to MRF (from the Income Fund), and monthly allowances are debited. At each fiscal year-end, an actuarial valuation determines the 100% funding requirements for MRF. Any amounts required to 100% fund MRF are transferred in the next fiscal year.

(3) Survivors' Retirement Fund (SRF) - Until January 1, 1999, all members with less than 20 years of service contributed 0.5% of salary to SRF. After January 1, 1999, there are no member contributions allocated to SRF. Interest is credited annually to SRF (from the Income Fund), and member savings are transferred to SRF from MSF upon the death of a vested member, and additional State contributions may be made in order to make SRF 100% funded. Survivors' monthly retirement allowances are paid from this fund upon the death of vested members, deferred vested members, and retirants.

(4) Insurance Revolving Fund (IRF) - Until January 1, 1999, all members contributed 0.5% of salary to the IRF. After January 1, 1999, there are no member contributions allocated to IRF. State contributions, if any, and interest from the Income Fund are credited to IRF. Life insurance benefits are paid from IRF to beneficiaries of members, deferred vested members, and retirants.

(5) Health Insurance Fund (HIF) - Until January 1, 1999, all members contributed 1% of salary to HIF. After January 1, 1999, member contributions are made as follows: (1) members who first became members on or before January 1, 1995, contribute 9% to HIF; and (2) members who first became members after January 1, 1995, contribute 7% to HIF. Funds from this reserve are used to pay health

care expenses and are accumulated to fully fund the future health insurance liabilities for MLRS.

(6) Income Fund (IF) - IF is credited with all investment earnings and other miscellaneous income. Interest transfers are made annually to the other reserves. IF also accounts for investment and administrative expenses and interest on refunds and transfers.

c. Fair Value of Investments

Plan investments are presented at fair value. Securities traded on a national exchange are valued at the last reported sales price at current exchange rates. Corporate bonds not traded on a national or international exchange are based on equivalent values of comparable securities with similar yield and risk. Other investments that do not have an established market are recorded at estimated fair value. Short-term investments are carried at cost, which approximates fair value.

d. Reporting Entity

MLRS is a pension trust fund of the State of Michigan. As such, MLRS is considered part of the State and is included in the *State of Michigan Comprehensive Annual Financial Report* as a pension trust fund. MLRS and the MLRS Board of Trustees are not financially accountable for any other entities. Accordingly, MLRS is the only entity included in this financial report.

e. Investment Income

Dividend income is recognized on the ex-dividend date, and interest income is recognized on the accrual basis as earned. Fair value changes are recorded as investment income or loss. Purchases and sales of investments are recorded as of the trade date.

f. Related Party Transactions

The cash account includes $3,448,128 and $1,169,131 on September 30, 2004 and September 30, 2003, respectively, which represents funds deposited in a common cash investment pool maintained for various State operating funds. The participating funds in the common cash pool earn interest at various rates depending upon prevailing short-term interest rates. Earnings from these activities amounted to $37,747 and $63,027 for the fiscal years ended September 30, 2004 and September 30, 2003, respectively.

g. Fixed Assets

Fixed assets, which are immaterial in amount, are not recognized on the accounting records. Administrative disbursements are treated as expenses, and equipment expenses are not capitalized.

Note 3 Contributions

a. Member Contributions

UNTIL JANUARY 1, 1999, the following contributions were made by members of MLRS:

Members who first became members on or before December 1, 1994, contributed 9% of their salaries to MLRS. The contributions were placed in the following reserves created by the enabling statute: 7% to the Members' Savings Fund for the first 20 years of service; 0.5% to the Survivors' Retirement Fund for the first 20 years of service; 0.5% to the Insurance Revolving Fund; and 1% to the Health Insurance Fund.

Members who first became members after December 1, 1994, contributed 7% of their salaries to MLRS. The contributions were placed in the following reserves created by the enabling statute: 5% to the Members' Savings Fund; 0.5% to the Survivors' Retirement Fund; 0.5% to the Insurance Revolving Fund; and 1% to the Health Insurance Fund.

AFTER JANUARY 1, 1999, the following contributions are made by the members of MLRS:

Members who first became members on or before December 1, 1994, contribute 9% of their salaries to MLRS. The contributions are placed in the Health Insurance Fund in accordance with the enabling statute.

Members who first became members on January 1, 1995, contributed 13% of their salaries to MLRS. The contributions were placed in the following reserves in accordance with the enabling statute: 4% to the Members' Savings Fund and 9% to the Health Insurance Fund until December 31, 2000. After December 31, 2000, these members contribute 9% of their salaries to MLRS. The contributions are placed in the following reserves in accordance with the enabling statute: 9% to the Health Insurance Fund.

Members who first became members after January 1, 1995, contribute 7% of their salaries to the MLRS. The contributions are placed in the Health Insurance Fund in accordance with the enabling statute.

Member contributions are tax-deferred through the provisions of section 414(h)(2) of the Internal Revenue Code.

b. State Contributions

State contributions are made on the basis of actuarial requirements as determined by the MLRS actuary and approved by the MLRS Board of Trustees. Through the annual State budgetary process, the Legislature annually appropriates, and the Governor approves, the State contributions along with certain court fee revenues, which are paid to MLRS pursuant to State statute. A chart showing State contributions is presented as required supplementary information.

Note 4 Investments

a. Investment Authority

All investments made are subject to approval by the MLRS Board of Trustees, which has investment authority under the Michigan Legislative Retirement System Act. Investments made are subject to statutory regulations imposed under the Public Employee Retirement System Investment Act (Act 314, P.A. 1965, as amended). MLRS also contracts with independent investment advisors.

b. Derivatives and Securities Lending

The plan did not have any investments in prohibited derivatives as defined in Act 314, P.A. 1965, as amended. Also, the plan did not participate in securities lending activities.

c. Investments Exceeding 5% of Plan Net Assets

MLRS did not hold an individual investment that exceeded 5% of net assets available for benefits at September 30, 2004 or September 30, 2003.

d. Categories of Investment Risk

Investments made by MLRS are represented by specific identifiable investment securities and are classified as to credit risk in three categories. Category 1 includes investments that are insured, registered, or held by MLRS or its agent in MLRS's name. Category 2 includes uninsured and unregistered investments that are held by the counterparty's trust department or agent in MLRS's name. Category 3 includes uninsured and unregistered investments that are held by the counterparty, its trust department, or agent, but not in MLRS's name. MLRS does not hold any investments classified as category 2 or category 3.

Certain types of investments are not categorized because they are not evidenced by securities that exist in physical or book entry form. Mutual funds are noncategorized investments. MLRS had 49.9% and 51.1% of its investments held in mutual funds at September 30, 2004 and September 30, 2003, respectively (for purposes of this note, the Comerica S&P 500 Fund is not included in the mutual fund percentage calculations, as it also has characteristics of a commingled trust).

INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL AND COMPLIANCE

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

Mr. R. Robert Geake, Chairperson
Board of Trustees
and
Ms. Christine I. Hammond, Director
Michigan Legislative Retirement System
Cora Anderson Building
Lansing, Michigan

Dear Mr. Geake and Ms. Hammond:

We have audited the financial statements of the Michigan Legislative Retirement System, as of and for the fiscal years ended September 30, 2004 and September 30, 2003, as identified in the table of contents, and have issued our report thereon dated April 15, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

<u>Internal Control Over Financial Reporting</u>
In planning and performing our audit, we considered the Michigan Legislative Retirement System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Michigan Legislative Retirement System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the State's management and the Legislature and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

Thomas H. McTavish

Thomas H. McTavish, C.P.A.
Auditor General
April 15, 2005

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress

Each time a higher level of benefit is adopted, unfunded obligations are created. The law governing the Michigan Legislative Retirement System (MLRS) requires that these additional obligations be financed systematically over a period of future years.

Analysis of the dollar amounts of actuarial value of assets*, actuarial accrued liability* (AAL), or unfunded actuarial accrued liability* (UAAL) in isolation can be misleading. Expressing the actuarial value of assets as a percentage of the AAL provides one indication of the MLRS funding status on a going-concern basis. Analysis of this percentage over time indicates whether MLRS is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the system. Trends in UAAL and annual covered payroll are both affected by inflation. Expressing the UAAL as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of MLRS progress in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the system.

Retirement Benefits
(in thousands)

Valuation Date September 30	Actuarial Value of Assets (1) (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded (Overfunded) Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio AAL (a/b)	Covered Payroll (2) (c)	UAAL as a Percentage of Covered Payroll (3) ((b-a)/c)
1995	$ 103,660	$ 105,866	$ 2,206	98%	$ 7,419	30%
1996	$ 113,633	$ 112,571	$ (1,062)	101%	$ 7,654	N/A
1997	$ 126,819	$ 116,263	$ (10,556)	109%	$ 7,836	N/A
1998	$ 131,836	$ 112,934	$ (18,902)	117%	$ 6,610	N/A
1999	$ 146,141	$ 127,096	$ (19,045)	115%	$ 4,195	N/A
2000	$ 160,254	$ 128,472	$ (31,782)	125%	$ 4,344	N/A
2001	$ 168,399	$ 138,621	$ (29,778)	121%	$ 4,284	N/A
2002	$ 167,158	$ 143,858	$ (23,300)	116%	$ 4,331	N/A
2003	$ 164,950	$ 147,431	$ (17,519)	112%	$ 2,016	N/A
2004	$ 161,905	$ 151,938	$ (9,967)	107%	$ 2,016	N/A

(1) Excludes reserve for health insurance.

(2) October-based payroll.

(3) Percentage of covered payroll is not applicable (N/A) as MLRS is overfunded and no contribution is required.

** See glossary at end of report for definition.*

Schedule of Contributions From the Employer and Other Contributing Entities

Fiscal Year	Valuation Date September 30	Required Contributions as a Percentage of Payroll (1)	Actual Payroll	Dollar Contribution For Fiscal Year Required	Actual
1995 - 1996	1995	26.97%	$ 7,564,764	$ 2,040,217	$ 2,151,697
1996 - 1997	1996	25.51%	$ 7,737,041	$ 1,973,719	$ 2,069,727
1997 - 1998	1997	19.79%	$ 8,197,494	$ 1,622,284	
1997 - 1998	1997 (2)	N/A	$ 8,197,494		$ 2,082,694
1998 - 1999	1998	N/A	$ 6,610,424		
1999 - 2000	1999	N/A	$ 4,194,546		
2000 - 2001	2000	N/A	$ 4,343,975		
2001 - 2002	2001	N/A	$ 4,284,113		
2002 - 2003	2002	N/A	$ 4,330,963		
2003 - 2004	2003	N/A	$ 2,016,113		
2004 - 2005	2004	N/A	$ 2,016,113		

(1) Required contributions are not applicable (N/A) as MLRS is overfunded and no contribution is required.

(2) After closing the defined benefit plan to members.

Note A Description

Ten-year historical trend information designed to provide information about the Michigan Legislative Retirement System's (MLRS's) progress in accumulating sufficient assets to pay benefits when due is presented in the preceding schedules. This information is presented to enable the interested parties to assess the progress made by MLRS in accumulating sufficient assets to pay pension benefits as they become due.

The comparability of trend information is affected by changes in actuarial assumptions, benefit provisions, actuarial funding methods, accounting policies, and other changes. Those changes usually affect trends in contribution requirements and in ratios that use the pension benefit obligation as a factor.

The schedule of funding progress and the schedule of contributions from the employer and other contributing entities are reported as historical trend information. The schedule of funding progress is presented to measure the progress being made to accumulate sufficient assets to pay benefits when due. The schedule of contributions from the employer and other contributing entities is presented to show the responsibility of the State in meeting the actuarial requirements to maintain MLRS on a sound financial basis.

Note B Summary Of Actuarial Assumptions

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation date	September 30, 2004
Actuarial cost method	Entry Age Normal
Amortization method	Level Percent-of-Payroll Open
Amortization period	12 years
Asset valuation method	5-Year Smoothed Market
Actuarial assumptions:	
Investment rate of return	7%
Projected salary increases	4%
Cost-of-living adjustments	4% - Annually compounded (non-compounded for legislators who first became members after January 1, 1995

GLOSSARY

actuarial accrued liability (AAL)	The difference between the actuarial present value of pension plan benefits and the actuarial present value of future normal costs; also referred to as "past service liability."
actuarial value of assets	The value placed at any particular date on the assets and liabilities of a retirement fund by the actuary responsible for the valuation of the assets and liabilities.
benefits	Payments to which participants may be entitled under the pension plan, including pension benefits, death benefits, and benefits due on termination of office.
deferred vested member	A member who leaves office and meets the service requirement but not the age requirement or a member who defers receipt of a retirement allowance until a future date.
domestic relations order	A judgment, decree, or order of the court made pursuant to the domestic relations law of the State and relating to the provision of alimony payments, child support, or marital property rights to a spouse of a participant under a judgment of separate maintenance or to a former spouse, child, or dependent of a participant.
entry age normal actuarial cost method	A method under which the actuarial present value of the projected benefits of each individual included in an actuarial valuation is allocated on a level basis over the earnings or services of the individual between entry age and assumed exit age.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.

HIF	Health Insurance Fund.
IF	Income Fund.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
IRF	Insurance Revolving Fund.
material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
member	A person elected to the Michigan House of Representatives or the Michigan Senate.
MLRS	Michigan Legislative Retirement System.
MRF	Members' Retirement Fund.
MSF	Members' Savings Fund.
pay-as-you-go basis	A method of financing a pension plan under which the contributions to the plan are generally made at about the same time and in about the same amount as benefit payments and expenses becoming due.
reportable condition	A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect

the entity's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements.

SRF	Survivors' Retirement Fund.
unfunded actuarial accrued liability (UAAL)	The difference between the actuarial accrued liability and the actuarial value of assets.
unqualified opinion	An auditor's opinion in which the auditor states that the financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting.

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